REPORT OF EXAMINATION
OF THE

EMPLOYERS COMPENSATION
INSURANCE COMPANY

AS OF
DECEMBER 31, 2004

Participating State
and Zone:

California

Filed May 12, 2006

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Los Angeles, California
March 24, 2006

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Gary L. Smith
Secretary, Zone IV-Western
Director of Insurance
Department of Insurance, State of Idaho
Boise, Idaho

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

EMPLOYERS COMPENSATION INSURANCE COMPANY

(hereinafter also referred to as the Company or ECIC) at the primary location of its books and records, 500 North Brand Boulevard, Glendale, California 91203.

SCOPE OF EXAMINATION

The previous examination of the Company was the qualifying examination, which was made as of August 29, 2002. This examination covers the period from August 30, 2002 through December 31, 2004. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; business in force by states; loss experience; accounts and records; and sales and advertising.

COMPANY HISTORY

The Company was incorporated in the State of California on May 16, 2002, under the name of Amyniles Insurance Company. On June 14, 2002, the Company filed its application for a permit with the Insurance Commissioner of the State of California authorizing it to sell and issue 52,000 shares of its $50 par value capital stock to its parent corporation, Employers Insurance Company of Nevada (EICN), A Mutual Company. The aggregate sale price of the shares was $91million. The purpose of the sale and issuance was to capitalize the Company in order to receive a Certificate of Authority to transact property and casualty insurance business in the State of California.

Effective July 1, 2002, the Company acquired the policy production and renewal rights and certain other tangible and intangible assets relating to Fremont Compensation Insurance Group's workers' compensation business.

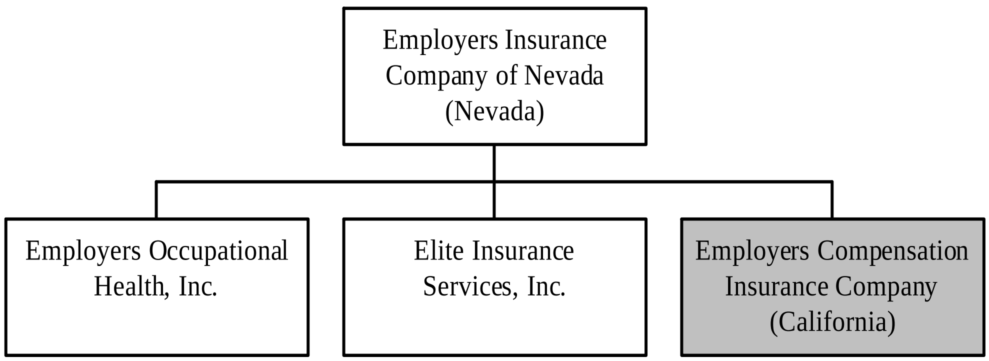
On August 22, 2002, the Company filed an amendment to its application to change its name from Amyniles Insurance Company to Fremont Employers Insurance Company. The Company commenced business on August 29, 2002. On September 23, 2003 the Company changed its name to Employers Compensation Insurance Company.

During 2002, the Company entered into a fronting agreement with Clarendon Insurance Group (Clarendon). Substantially all premiums during 2002 were written under the fronting agreement. On September 9, 2003 the Company received an A.M. Best pooled rating of "A-". Due to this rating, the Clarendon fronting agreement was placed into runoff in 2003.

As noted in the "Growth of Company" section in this report, the Company's parent contributed a total of $86 million to the Company during 2003 and 2004. In 2005, the Company's parent contributed an additional $40 million.

MANAGEMENT AND CONTROL

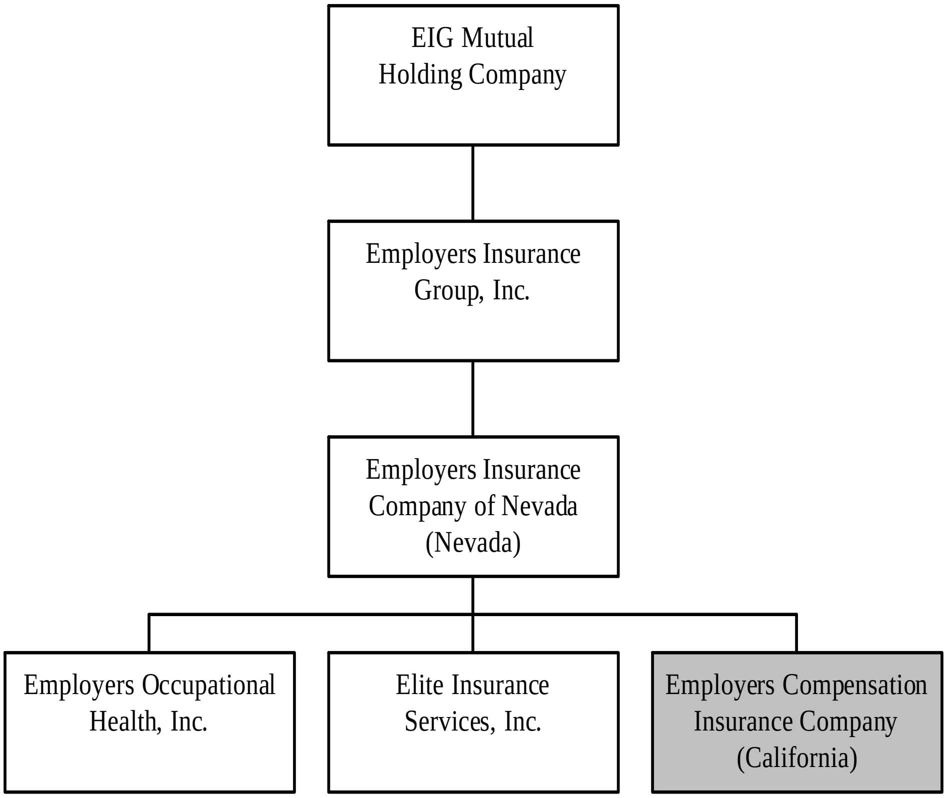
As of December 31, 2004, the Company was a wholly-owned subsidiary of Employers Insurance Company of Nevada (EICN), A Mutual Company, domiciled in Nevada. The following organizational chart depicts the Company's relationship within the holding company system as of December 31, 2004: (all ownership is 100%)



Subsequent to the examination date, the group partially reorganized its structure adding two new holding company entities (one mutual, the other stock) above EICN, while demutualizing EICN.

On March 22, 2005, the mutual policyholders of EICN approved a plan in which their mutual members' rights were exchanged for members' rights in the newly formed EIG Mutual Holding Company (EIG Mutual), which became the ultimate parent of the group. Concurrently, EIG Mutual created, and owns 100% of, a newly formed intermediate-level holding company, Employers Insurance Group, Inc, (a Nevada Corporation).

Effective April 1, 2005 EICN completed the demutualization process, changing its legal structure to that of a Nevada stock insurance company. Employers Insurance Group, Inc. now owns 100% of EICN. EICN continues to own 100% of Employers Compensation Insurance Company (ECIC). Despite the reorganization there was no change in the direct ownership of ECIC, nor was there effective change in the ultimate ownership, which still resides with the former mutual policyholders of EICN. The following organizational chart depicts the Company's relationship within the holding company system after the reorganization: (all ownership is 100%)



Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

<u>Directors</u>

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Robert J. Kolesar Las Vegas, Nevada	Partner Kolesar & Leatham Law Firm
Douglas D. Dirks Reno, Nevada	President Employers Insurance Company of Nevada
Leonard T. Ormsby Reno, Nevada	Executive Vice President Employers Insurance Company of Nevada

Principal Officers

Name	Title
Douglas D. Dirks	President and Treasurer
Leonard T. Ormsby	Executive Vice President and General Counsel
Ann W. Nelson	Executive Vice President – Corporate Development
John Nelson	Senior Vice President – Chief Administrative Officer
Paul Ayoub	Senior Vice President – Chief Investment Officer
Stephen Festa	Senior Vice President – Claims
Martin J. Welch	Senior Vice President – Underwriting
Barry M. Lapidus	President, California Region
George F. Tway	President, Western Region
Cynthia M. Morrison	Vice President and Corporate Controller
Michael T. Stock	Vice President, Chief Deputy General Counsel and Secretary

Management Agreements

Amended and Restated Administrative Services Agreement: Effective August 30, 2002, the Company and its parent, Employers Insurance Company of Nevada (EICN), entered into an Amended and Restated Services Agreement. The agreement provides for each party to perform certain services and that each party will reimburse the party providing the service for all direct and directly allocable expenses. Pursuant to the agreement, the Company provides the following services to EICN: accounting, collections, premium audit, loss control, administrative management, human resources, underwriting, information technology (IT), and fraud investigations. EICN will provide the following services to the Company: actuarial, investment, payroll, budget and financial planning, internal audit, marketing, corporate communications and IT. Under the terms of the agreement, the Company received net payments from EICN in the amounts of $1,227,610 and $2,750,594 for the years 2002 and 2003, respectively, and ECIC made net payments to EICN of $1,185,439 in 2004. The California Department of Insurance (CDI) approved this agreement on February 28, 2003.

Services Agreement: The Company is party to a Services Agreement with Elite Insurance Service, Inc. (Elite), an affiliated agency. The Company provides policy administration, actuarial services, marketing, financial reporting, tax, treasury, computer and other services on a direct cost reimbursement basis. Under the terms of the agreement, Elite paid the Company $9,495,768, $29,015,763 and $8,711,818 for the years 2002, 2003 and 2004, respectively.

Investment Management Agreement: Effective March 5, 2005, the Company and its affiliates entered into an investment management agreement with Conning Asset Management Company (Conning). Under the terms of this agreement, Conning provides investment advisory and portfolio management services in accordance with the Company's investment guidelines. Fees of .0875% of the assets market value are paid on a quarterly basis for these services.

Tax Sharing Agreement: The Company and its affiliates are part of a consolidated federal income tax agreement with its parent, EICN. Allocation of taxes is based upon separate return calculations with inter-company tax balances generally settled based on when the taxes would be due to the IRS on a stand alone basis. The CDI approved this agreement on November 21, 2003.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the Commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed that neither report of the qualifying exam was presented to the board.

The Company is not in compliance with CIC Sections 1200 and 1201. The Company's minutes failed to document the authorization or approval of its investments, which is in violation of CIC Section 1200. In addition, specific references to amounts, facts and the values of the securities were not included as required under CIC Section 1201.

It is recommended that the Company comply with CIC Sections 735, 1200 and 1201.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Company was licensed to transact business in California, Colorado, Montana, Idaho, and Utah. During 2005, the Company obtained licenses in the states of Texas, Arizona, Oregon and New Mexico.

The Company's business is written through independent agents. The only line of business written is workers' compensation insurance. In 2004 direct premiums written were $282,209,175.

For the year ended December 31, 2004, the direct premium written by states was as follows:

State	Direct Premium Written	Percentage of Total
California	$ 277,095,787	98.2%
Colorado	$ 2,353,457	.8%
Utah	$ 1,974,494	.7%
Montana	$ 471,634	.2%
Idaho	$ 313,803	.1%

The Company's home office is located in Glendale, California. The Company's accounting and finance functions are performed primarily in Glendale, California, except for certain investment, payroll and treasury functions, which are performed in Reno, Nevada. The Company currently maintains branch offices in Fresno, Glendale and San Francisco, California, Boise, Idaho and Denver, Colorado. All of the Company's underwriting files are located in the producing office; claims files are located in the office currently handling the claim.

GROWTH OF COMPANY

The Company reported significant growth in direct and net premiums written and surplus during the period under examination as follows:

Year	Direct Premium Written	Net Premium Written	Surplus
2004	$ 282,209,175	$ 198,534,632	$ 205,230,636
2003	$ 43,340,163	$ 184,179,847	$ 143,408,401
2002	$ 664,290	$ 71,713,616	$ 80,645,583

During 2002, and a portion of 2003, the Company produced the majority of its business through a fronting agreement with Clarendon Insurance Group, Inc (Clarendon). The 2003 growth in net premiums written was primarily due to a full year of premium from the fronting arrangement with Clarendon. In addition, effective July 1, 2003, the Company entered into a pooling agreement with its parent. The 2004 increase in net premiums written was primarily the result of the Company's market growth. Significant increases in surplus were the result of the Company's parent, EICN, contributing $30 million and $56 million to the Company in 2004 and 2003, respectively. In 2005, EICN contributed an additional $40 million.

REINSURANCE

Inter-Company Pooling Agreement

Effective July 1, 2003, the Company entered into a reinsurance pooling agreement with its parent, Employers Insurance Company of Nevada (EICN). Under the terms of the agreement, 100% of the Company's business written, net of reinsurance, is ceded to and pooled with business written by EICN. EICN then cedes 47% of the combined premiums back to the Company. Losses, loss adjustment expenses and underwriting expenses are also combined and pooled in the same percentages.

Assumed

In July 2002, the Company entered into a reinsurance assignment and assumption agreement with Harbor Specialty Insurance Company and Clarendon National Insurance Company (collectively, referred to as Clarendon), and the Company's parent, EICN. The Company assumes all of EICN's rights, duties, obligations, liabilities and risks under a reinsurance quota-share agreement in which EICN and Clarendon were parties. The Company assumes 90% of losses on business produced by Elite Insurance Services, Inc. (Elite), which are less than or equal to $1 million. The Company also assumes 100% of Elite's losses in excess of $1 million, less actual recoveries received by Clarendon from all other reinsurance. In addition, the Company assumes 100% of losses on business produced by Fremont General Insurance Agency, Inc., less actual recoveries received by Clarendon from all other reinsurance.

In November 2003 the Company entered into a 100% quota share reinsurance agreement with Virginia Surety Company, Inc. (VSC), domiciled in Illinois, where the Company assumes 100% of VSC's workers' compensation and employers' liability business produced through Elite.

Ceded

In 2002, the Company's reinsurance program consisted of multi-layer excess of loss and catastrophic coverage's with various reinsurers. The Company retained the first $1 million of losses per occurrence with excess reinsurance coverage up to $100 million. In 2004, the Company increased its retention limit to the first $1.5 million of losses per occurrence. The following is a summary of the Company's principal ceded reinsurance contracts in force as of December 31, 2004:

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Excess of Loss			

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
First Layer	62.50% Various Lloyd's of London Syndicates 22.50% Ace Property & Casualty Insurance 15.00% Aspen Insurance U.K. Limited	$1.5 million	$3.5 million Excess of $1.5 million
Second Layer	42.50% Various Lloyd's of London Syndicates 30.00% American Re-Insurance Company 17.50% Aspen Insurance U.K. Limited 10.00% GE Reinsurance Corporation	$5 million	$5 million Excess of $5 million
Excess Catastrophe			
First Layer	52.50% Various Lloyd's of London Syndicates 25.00% Endurance Specialty Insurance Ltd. 10.00% Odyssey America Reinsurance Corp. 7.50% Catlin Insurance Company Ltd. 5.00% Aspen Insurance U.K. Limited	$10 million	$10 million Excess of $10 million
Second Layer	45.00% Various Lloyd's of London Syndicates 25.00% Endurance Specialty Insurance Ltd. 10.00% Aspen Insurance U.K. Limited 7.50% Catlin Insurance Company Ltd 7.50% Odyssey America Reinsurance Corp 5.00% Ace Property & Casualty Insurance	$20 million	$30 million Excess of $20 million
Third Layer	31.80% Various Lloyd's of London Syndicates 25.00% Endurance Specialty Insurance Ltd. 10.00% Catlin Insurance Company Ltd 10.00% Allied World Assurance Company. Ltd 10.00% Montpelier Reinsurance Limited 8.20% Aspen Insurance U.K. Limited 5.00% Ace Property & Casualty Insurance	$50 million	$50 million Excess of $50 million

At December 31, 2004 the Company reported an asset entitled "Funds held or deposited with reinsured companies" in the amount of $689 million. The Company also reported "Funds held by company under reinsurance treaties" liability in the amount of $366 million. The majority of the asset and the entire liability were recorded as a result of the pooling agreement with the Company's parent, EICN. The remaining asset of $134.5 million is receivable from the Clarendon Group. The entire net asset (net of the funds held liability) is secured by offsetting loss reserves.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders
from August 29, 2002 through December 31, 2004

Statement of Financial Condition
as of December 31, 2004

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 358,367,455	$	$ 358,367,455	(1)
Cash and short-term investments	43,302,405		43,302,405	
Investment income due and accrued	3,677,948		3,677,948	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	13,373,060	2,319,956	11,053,104	
Premiums, agents' balances and installments booked but deferred and not yet due	22,050,730	954,707	21,096,023	
Accrued retrospective premiums	981,787		981,787	
Funds held by or deposited with reinsured companies	689,114,309		689,114,309	
Federal income tax recoverable	432,092		432,092	
Net deferred tax asset	47,945,593	35,927,502	12,018,091	
Electronic data processing equipment	1,452,720	75,648	1,377,072	
Furniture and equipment	143,710	143,710	0	
Aggregate write-ins for other than invested assets	908,685	904,285	4,400	
Total assets	$1,181,750,494	$ 40,325,808	$1,141,424,686	

Liabilities, Surplus and Other Funds

Losses		$ 419,733,943	(2)
Loss adjustment expenses		92,478,450	(2)
Commissions payable, contingent commissions and other similar charges		4,892,887	
Other expenses		5,818,668	
Taxes, licenses and fees		5,616,917	
Unearned premiums		38,766,486	
Dividends declared and unpaid: Policyholders		21,483	
Ceded reinsurance premiums payable		182,250	
Funds held by company under reinsurance treaties		365,944,747	
Payable to parent, subsidiaries and affiliates		2,239,550	
Aggregate write-ins for liabilities		498,669	
Total liabilities		936,194,050	
Common capital stock	$ 2,600,000		
Gross paid-in and contributed surplus	174,400,000		
Unassigned funds (surplus)	28,230,636		
Surplus as regards policyholders		205,230,636	
Total liabilities, surplus and other funds		$1,141,424,686	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income		
Premiums earned		$ 190,860,554
Deductions:		
Losses incurred	$ 94,141,307	
Loss expense incurred	22,780,053	
Other underwriting expenses incurred	55,969,673	
Total underwriting deductions		172,891,033
Net underwriting gain		17,969,521
Investment Income		
Net investment income earned	$ 6,666,172	
Net realized capital loses	(2,879,298)	
Net investment gain		3,786,874
Other Income		
Net gain from agents' balances charged off	$ 1,018,515	
Aggregate write-ins for miscellaneous income	18,838,364	
Total other income		19,856,879
Net gain before dividends to policyholders and before federal income tax		41,613,274
Dividends to policyholders		1,295,109
Federal income taxes incurred		10,929,908
Net income		$ 29,388,257

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		$ 143,408,401
Net income	$ 29,388,257	
Change in deferred income tax	3,888,505	
Change in nonadmitted assets	(1,608,108)	
Change in provision for reinsurance	153,581	
Surplus paid-in	30,000,000	
Change in surplus as regards policyholders		61,822,235
Surplus as regards policyholders, December 31, 2004		$ 205,230,636

Reconciliation of Surplus as Regards Policyholders
from August 29, 2002 through December 31, 2004

Surplus as regards policyholders, August 29, 2002, per Examination			$ 90,800,000
	Gain in Surplus	Loss in Surplus	
Net income	$ 20,810,851	$	
Change in deferred income tax	47,945,593		
Change in nonadmitted assets		40,325,808	
Surplus adjustments: Paid-in	86,000,000		
Totals	$154,756,444	$40,325,808	
Net increase in surplus as regards policyholders			114,430,636
Surplus as regards policyholders, December 31, 2004, per Examination			$205,230,636

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

A review of the captioned account disclosed that approximately $50 million in bonds, money market accounts and accrued interest were held in a trust account for the benefit of Harbor Specialty Insurance Company and Clarendon National Insurance Company (collectively, referred to as Clarendon) as of December 31, 2004. The assets held in the trust account are in addition to the funds withheld of $134.5 million. Together, the balances serve as the secured obligations required by the reinsurance assignment and assumption agreement noted previously in this examination report. The trust account and the funds withheld were required by Clarendon to provide for collateralization of the reinsurance premium plus an additional 14.9% to allow for an assumed loss ratio of 72.5%.

Neither the trust agreement nor the reinsurance agreement stipulates a release date of the amounts held in the trust account. According to the Company, the amount of the secured obligations required is at the sole discretion of Clarendon.

Pursuant to the trust agreement, the assets held in the trust are held in the name of Wells Fargo Bank, the trustee, for the sole use and benefit of Clarendon as beneficiary. According to Wells Fargo Bank, as stated on the bank confirmation, the Company (Grantor of the trust) does not own the assets in the trust account. Withdrawals from the trust account may be made at Clarendon's sole discretion upon written instruction to the trustee, at any time without any further act or notice by Clarendon or Wells Fargo Bank to the Company. The assets held in the trust are to secure payment and performance of all the liabilities and obligations of the Company to Clarendon under the reinsurance agreement.

The Company reported approximately $134.5 million of outstanding loss reserves assumed from Clarendon as of December 31, 2004 in conjunction with this business. The funds withheld and the assets held in trust create an over collateralization of approximately $50 million as of December 31, 2004 (excess of funds withheld and trust assets over the outstanding loss reserves). The interest income earned on the assets held in trust remains with and is added to the trust account balance.

Statements of Statutory Accounting Principles (SSAP) No. 4, Section 2(b) require a company to have control of its assets in order for them to be admissible. In addition, Section 3 states, in part, that assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet and are, therefore, considered non-admitted. In addition, SSAP No. 62 Section 20 requires that funds withheld or deposited with reinsured companies, are admissible assets only to the extent that they do not exceed the liabilities they secure.

The reinsurance and the trust agreements were approved by the California Department of Insurance (CDI) in June 2002. The agreements were submitted to the CDI by the Company in conjunction with the initial application for a certificate of authority. The Company's business plan required the utilization of the fronting arrangement with Clarendon to write business. It was not anticipated at the date of approval that the loss ratios assumed in the calculations for the trust requirements would improve materially but they did and this created the over collateralization.

In March 2006, subsequent to the examination date, Clarendon returned approximately $35 million of the bonds held in the trust account to the Company. It is also anticipated that upon further review Clarendon will release additional funds. Based upon the subsequent release and the anticipated additional release of funds, the assets held in the trust account were admitted for the purpose of this examination report.

It is recommended that the Company continue to make all efforts necessary to negotiate the release of the trust assets that represent an over-collateralization at the earliest possible date.

It was also noted that the assets held in the above trust account were not disclosed in the Company's Annual Statement in accordance with annual statement instructions, which require that all assets which are not for the benefit of all policyholders, claimants and creditors of the Company be itemized on Schedule E.

Although no longer applicable since the Company has now been in business for more than three years, it was noted that during the period under examination the Company was not in compliance with California Insurance Code (CIC) Section 1153.5. This CIC Section requires a company, during the first three years of commencement of business, to maintain its invested assets in securities specified in CIC Sections 1170 to 1175. The investments specified in those Sections consist of Federal, State and Municipal obligations and obligations of Canada and Puerto Rico. A review of the Company's investment portfolio disclosed that the Company invested in corporate obligations throughout its first three years of operations.

(2) Losses and Loss Adjustment Expenses

The Company was directed by the California Department of Insurance (CDI), under CIC Section 733(g), to retain an independent actuary for the purpose of assisting this examination in determining the reasonableness of the Company's loss and loss adjustment expense reserves. Based on the analysis by the independent actuary and the review of their work by a Casualty Actuary from the CDI, the Company's December 31, 2004 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination report.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Corporate Records (Page 6): It is recommended that the Company implement procedures in its board meetings to ensure compliance with California Insurance Code (CIC) Sections 735, 1200 and 1201.

Bonds (Page 15): It is recommended that the Company continue to make all efforts necessary to negotiate the release of the trust assets that represent an over-collateralization at the earliest possible date.

Bonds (Page 15): It is recommended that the Company properly report all assets which are not for the benefit of all policyholders' claimants and creditors on Schedule E of the Annual Statement.

Bonds (Page 15): The Company did not comply with CIC Section 1153.5 for the period covered by the examination. This section is no longer applicable as the Company has been in business longer than three years.

Previous Report of Examination

None.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Constance J. Korte, CFE
Examiner-In-Charge
Department of Insurance
State of California